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C O N F I D E N T I A L SANTO DOMINGO 001253

SIPDIS

TREASURY: PLEASE PASS TO SARA SENICH

E.O. 12958: DECL: 10/23/2019
TAGS: ECON EFIN PGOV PREL DR
SUBJECT: CENTRAL BANK GOVERNOR CAUTIOUSLY OPTIMISTIC ON
ECONOMIC/FINANCIAL PROSPECTS

Classified By: Political-Economic Counselor Alexander Margulies.
Reason: 1.4(b/d).

SUMMARY

¶1. (C) Summary: Dominican Central Bank Governor Hector Valdez Albizu, during a 10/22 meeting with Charge, expressed his optimism that the Dominican Republic (DR) would register 2.5 to three percent growth this year, rising to above five percent growth in 2010. He acknowledged that the Government of the Dominican Republic (GoDR) faced difficult budget choices in the coming year, but thought that the pending Stand-By Agreement with the International Monetary Fund (IMF), implementation of World Bank and Inter-American Development Bank loans and up to USD 500 million in new sovereign bond issues would see the country through the remaining rough spots ahead. Valdez was the driving force behind the GoDR's eventual approach to the IMF and promises to maintain a firm hand on the monetary tiller. He is concerned, however, that the ongoing constitutional reform process will result in increased political influence over monetary policy. END SUMMARY.

¶2. (U) Valdez was accompanied at the meeting by Pedro Silverio, Manager of the Central Bank, and Manuel Gomez Copello, Assistant Manger and Director of the Department of Human Resources. Charge was accompanied by PolEcon Counselor and EconChief.

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ECONOMICS OVERVIEW: SOME RECOVERY, MORE DECISIONS
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¶3. (C) Valdez began his overview of economic conditions in the country by highlighting the limited fiscal space available to the GoDR as a result of the global economic and financial crisis. He blamed the USD 600 million fall in revenues on the fall in exports to the United States, the DR's major trading partner, and a reduction in domestic consumption. He stressed that the Dominican Republic is very open to trade and its economy relies on external inputs (remittances, services, and tourism, in particular), all of which have plunged since the start of the crisis. He expressed his hope that the IMF Standby Agreement would help attract investors, given the stability that comes with the IMF's involvement in the economy. He then opined that other

countries in Latin America were faring far worse than the DR, whose economy he expects to grow by 2.5 to three percent, recalling a presentation he attended at the Bank/Fund annual meeting in Istanbul in which the presenter asserted the DR was one of six countries in Latin American that have best weathered the global crisis. (NOTE: He did not provide the source of that figure. END NOTE.)

¶4. (C) Turning to the exchange rate, Valdez displayed a graph showing that many of the larger countries in Latin America, such as Brazil and Colombia, had experienced significant appreciation over the last few months whereas the smaller countries, like the DR, were seeing depreciation, which, in theory, should help their export markets. Valdez noted the DR had only experienced a two percent depreciation, and proudly pointed out that the country had the lowest inflation rate in Latin America. (NOTE: The peso has depreciated 3.2 percent year-on-year based on October 22 figures. END NOTE.) Looking ahead, he called 2010 a year for recuperation, thanks in part to the IMF program, and stressed the importance of stimulating the private sector. He fondly recalled the days of seven and eight percent GDP growth rates in the DR, but thought GDP growth would reach five percent next year. (NOTE: The IMF predicts real GDP growth to be .5 to 1.5 percent in 2009; the Economist Intelligence Unit expects it to be 1.5 percent in 2009 and 2.6 percent in 2010. END NOTE.)

¶5. (C) Although many observers, particularly the credit rating agencies, have identified the DR's weak liquidity position as an area of particular concern, Valdez demurred on the issue. In terms of international reserves, he recalled that they were negative when he arrived on the job as

Governor, though they now exceed USD 1.5 billion. In terms of the Bank's liquidity, he explained that it had expended a great number of resources during the crisis and that this expenditure came at a cost to the government, which now had to tackle the deficit and reduce spending. He was pointed on the question of the budget, noting that the government had to adopt austerity measures and that difficult work lay ahead. Whereas the Bank acted to reduce interest rates as GoDR spending fell, the income from the IMF, World Bank and IDB loans will soon require Valdez to tighten the reins and raise interest rates. He predicted that the Hacienda would cut its planned-yet-still-unrealized USD 1 billion bond issuance to USD 500 million, given the funds to be made available by the IMF Agreement and those still remaining through PetroCaribe. He also expressed his belief that the government and the Central Bank would be in much stronger positions within the next four years.

POLITICAL THOUGHTS: DRUGS AND HACKS

¶6. (C) Responding to a question from the Charge, Valdez downplayed the effects of the drug trade on the economy, stating that any effect it did have would be dwarfed by the major engines of the economy, such as tourism. He also expressed his belief that strict accounting regulations in the banking sector limited the crossover of drug money into the local economy. To the extent that it was present, he added, it mostly affected the real estate and vehicle markets. Pedro Silverio went further, opining that the DR was only a transit country and that the vast majority of the money derived from the drug trade stayed in the destination and origin countries.

¶7. (SBU) Valdez became particularly energized when discussing constitutional reform. He decried the approved, though as yet unpromulgated, provision that would place more power in the hands of the Junta Monetaria (Monetary Board) at the expense of the Governor, creating a scenario where non-expert political appointees would have increased influence over monetary policy.

COMMENT

¶8. (C) COMMENT: Valdez is currently in his third term as Central Bank Governor under Leonel Fernandez (including Fernandez' 1996-2000 term) and his fourth term overall. He told us he has 35 years of total experience with the Central Bank. He earned his reputation as a reliable, independent voice when he pressed the government to approach the IMF, putting him publicly at odds with the President and the Secretary of State for Finance, both of whom initially opposed the move. Vindicated by the announcement of the Standby Agreement, Valdez will continue to grapple with the Central Bank's limited ability to promote economic growth and defend the peso from further depreciation as well as keep an eye on the continued upward creep of inflation. With congressional and municipal elections looming in May, Valdez' commitment to a responsible monetary policy (raising interest rates) and resistance to political influences will be tested, but he appears to be up to the challenge. END COMMENT.
LAMBERT